Interpreting the East Asian Economic Crisis

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Abstract: This paper provides an overview and analysis of the East Asian economic crisis which began in 1997. It provides an assessment of the nature and prospects for East Asian style capitalism in a global environment, and analysis of competing explanations of East Asia's successes and failures.

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Introduction

In the middle of 1997 East Asia was gripped by a major financial crisis that shows little sign of abating. What was initially taken to be a relatively isolated shock has intensified and generated increasingly widespread economic and political effects which threaten to overturn much of the region's established political and economic order. These events have been remarkable enough in themselves. For observers of the region there has been an additional, if rather less traumatic consequence of the crisis: quite simply, it has forced a major reassessment of our understanding of the way political and economic activity is organised within the region, and about the place of the region in an increasingly integrated international system.

The key question to emerge in the wake of the crisis is whether we are witnessing the end of Asian capitalism in its various dirigiste or predatory manifestations. In short, have East Asian forms of capitalism been undone by inherent structural contradictions that make them simply unsustainable, or have they been undermined by an external forces associated with global financial markets and the activities of powerful actors like the International Monetary Fund (IMF) or the United States? Whatever the origins of the crisis, is 'Asian capitalism' in the process of moving toward a more liberal, market-centred order?

Despite differences in emphasis on global and domestic factors, on institutional and social factors, there is a general belief amongst this volume's authors that it is simply not possible to understand the recent events in East Asia without considering the integrated nature of economic and political factors. Although one of the central questions with which this entire volume seeks to deal revolves around the form and future of capitalist organisation in East Asia, it is worth emphasising at the outset that any form of economic organisation is ultimately an expression of institutional frameworks and the particular sorts of social relations embedded in them. In other words, although there are some fairly basic qualities which define capitalism anywhere, its specific manifestation will reflect the particular constellations of political and economic power within which it is embedded. Hence, the volume is distinguished by its questioning of the neo-classical/rational choice proposition that capitalist markets are mechanisms defined by natural laws of equilibrium, and driven by the rational choices of utility-maximising individuals.

Before introducing the region's more distinctive modes of political and economic organisation, we shall provide a brief sketch of the crisis itself, and indicate the scale of its impact. The broad intention of this chapter is to indicate the main themes that run through the volume and give a preliminary indication of the other contributions that make it up. In addition, we shall identify some of the key questions which have emerged from the crisis. At the outset let us broach the most fundamental of all: is this a crisis of East Asian capitalism, or a crisis of capitalism more generally? As the impact of the crisis spreads relentlessly outwards, are the problems being revealed by its progress less to do with the 'crony capitalism' of Asian business–government relations, or even the 'irrational exuberance' of financial markets, than they are with the contradictory and inherently crisis-prone nature of capitalism in general?

What the analyses contained in this volume reveal is the complexity of the factors that have not simply shaped the crisis, but which are determining its continuing evolution. Central in this regard are an array of national and international forces that are increasingly and overtly political. Whether it is the contest to shape domestic policy responses in Korea, or the friction between IMF and Indonesia, the crisis has never been simply an economic event. Indeed, the IMF's role is indicative of the essentially political impact of nominally economic policy advice. The IMF has provoked both resistance and enthusiasm, influencing the struggle over policy agendas throughout the region, and being instrumental in the downfall of the governments of Korea, Thailand and, most dramatically, Indonesia. Significantly, the results and dynamics of such struggles have been different in each country. Exactly why is a matter of contention, with some stressing the clash between global financial markets and domestic institutions, while others emphasise the importance of constellations of power and interest in shaping outcomes.

It is precisely because the crisis is an inescapably political phenomenon, however, that the essays collected here are able to shed such a penetrating light on what is arguably the most important event in the region, if not the world, since the end of the Second World War. To put the matter somewhat baldly, what is at stake here is the future pattern of economic and political organisation in a region which was until recently routinely taken to be the most dynamic on earth. However - or whenever - the crisis is resolved, the nations of East Asia will continue to be of primary importance, if for no other reason than a substantial proportion of the world's population lives there. What is of equal importance, therefore, is the region's relationship with the rest of the world. The spreading of crisis demonstrates that, for good or ill, East Asia now has the capacity to move the world.

While immediate policy attention focuses on whether existing regimes can emerge intact from the crisis by introducing Keynesian reflationary policies or by attempting to control domestic and global capital markets, the crisis begs other, more fundamental questions. For example, are Asian forms of capitalism simply in transition towards a universal capitalist model shaped by an intrinsic instrumental rationality? Or may various capitalisms exist within a range of institutional frameworks? Most importantly, how do economic systems change?

In the intense debate that has emerged in the time since the crisis took hold, there major questions have emerged. First, is the crisis a phenomenon that has its roots in changes in the structure of global capital markets that make economies more unstable (Sachs, Krugman, Winters), or in movements in currencies that change international coemptive advantages (Haggard and McIntyre)? Or were the crises generated from within, propelled by shifts in the balance of power and interest among political and social coalitions or the collapse of institutions? While there is a general recognition that particular outcomes must be explained in terms of the interaction between a range of political and economic factors at both the domestic and global levels, the authors in this book nevertheless privilege particular forces.

Winters, Higgott and Leaver, for example, emphasise factors at work in the global political economy, whereas Weiss and Hobson, Moon and Rhyu, Kim and Lee, and Kim all suggest that the disintegration of institutional capacities within particular economies is at the heart of the region's problems. For Robison and Rosser, Khoo, and Hewison, shifts in the architecture of power or interest have played an especially critical role. Beeson and Bell, by contrast, suggest that all of these factors have affected Australia's relationship with the region. Clearly, there is a good deal of debate about where the appropriate explanatory emphasis should lie even amongst broadly sympathetic scholars. In order to better appreciate such differences of opinion, it is as well to remind ourselves of both its origins and impact.

Measuring the meltdown

Although the crisis has by now become a staple of popular commentary, it is important to remind ourselves at the outset of quite how profound a transformation there has been in the fortunes of the region. Jeffrey Winters (Chapter ??) provides a detailed analysis of the dynamics that drove the initial currency crisis, which we shall complement here by briefly sketching its impact on the region. Having done that, we locate the countries of East Asia within an overarching global framework. For as Richard Higgott observes in chapter ??, the East Asian crisis is also the first 'crisis of globalisation'. It is important, therefore, to say something about the increasingly inter-connected and internationalised system within which the East Asian meltdown occurred. This will enable us to begin the task of establishing how much of the current crisis is a product of the problems of East Asian capitalism, and how much may be a function of longer term changes in the wider global political economy.

The possibility that a number of East Asian economies might have potentially serious problems first became really apparent as a consequence of the Thai currency crisis. While there were a number of earlier warning signs that might – indeed, <u>should</u> – have caused concern in retrospect (see the chapters on South Korea by Moon and Rhyu, and by Kim in this volume, for example), these were overlooked in the euphoria associated with the generalised 'East Asian miracle'. As Kevin Hewison points out in chapter ??, the Thai developmental experience has been highly distinctive and has little in common with many other countries, yet there was little recognition of these differences or the potential for the Thai economy to collapse. What was perhaps an even greater shock was the possibility that the problems of one economy might by transmitted through the so-called 'contagion effect' to other economies with little obvious connection, other than inescapable geographical contingence. As Figure 1 demonstrates, however, the impact when it came was all too real.

Not only did currencies like Indonesia's rupiah lose about 80 per cent of its value in the space of a few months, but regional equity markets were equally decimated as 'investors' scrambled to leave what were perceived to have become highly risky investment prospects. This rapid capital exit which has clearly been central to the scale and rapidity of the transformation of the region's position becomes more comprehensible when the composition of capital is considered. As Table 1 shows, the economies of the region in general, and Southeast Asia in particular, had increasingly utilised and become dependent on highly liquid forms of portfolio or bank mediated credit. Such inflows of capital were generally denominated in US$ and – compounding the potential risks of this strategy – unhedged.

The consequences of a growing reliance on 'hot' money from the world's increasingly integrated and massive financial markets have by now become all too apparent. As a number of the contributors in this volume make clear, a strategy of currency 'pegging' was always fraught with potential danger: not only was it always vulnerable to speculative attacks from the world's financial markets, but it systematically undermined the competitive position of the overall economy.

Table 1. External Financing for Five Asian Economies
($US billions)

	1994	**1995**	**1996**	**1997e**[ii]	**1998f**[ii]
External financing, net	47.4	80.9	92.8	15.2	15.2
Private Flows, net	40.5	77.4	93.0	-12.1	-9.4
Equity investment	12.2	15.5	19.1	-4.5	7.9
Direct Equity	4.7	4.9	7.0	7.2	9.8
Portfolio Equity	7.6	10.6	12.1	-11.6	-1.9
Private Creditors	28.2	61.8	74.0	-7.6	-17.3
Commercial banks	24.0	49.5	55.5	-21.3	-14.0
Non-bank private creditors	4.2	12.4	18.4	13.7	-3.2
Official flows, net	7.0	3.6	-0.2	27.2	24.6
International financial institutions	-0.4	-0.6	-1.0	23.0	18.5

Bilateral creditors	7.4	4.2	0.7	4.3	6.1
Resident lending/other, net	-17.5	-25.9	-19.6	-11.9	-5.7
Reserves excluding gold (= increase)	-5.4	-13.7	-18.3	22.7	-27.1

Notes: (I) South Korea, Indonesia, Malaysia, Thailand and the Philippines; (ii) including resident net lending, monetary gold, and errors and omissions; (iii) e = estimate, f = IIF forecast. Source: Institute of International Finance.

Equally rapid was the transmission of these financial sector shocks to the underlying 'real' economies on the region. We shall say more about this important distinction below, but at present we merely want to emphasise the scale of the downturn in the troubled economies. As Tables 2 and 3 indicate, across a number of key indices like unemployment, interest, inflation and growth rates, the position of the East Asian economies has been profoundly altered. From being synonymous with unparalleled growth rates and seemingly limitless prospects, the region now finds itself at the centre of an equally dramatic downward spiral of negative growth and rising unemployment.

Table 2: Unemployment, Interest Rates

Country	Unemployment (%)		Prime Rate (%)	
	Jun 97	Jun 98	Jul 97	Jul 98
China			6.8 (Apr 98)	
Hong Kong	2.5	4.2	8.75	10.0
Indonesia	14.2	16.8	18.25	65.0
Malaysia	2.7	5.0	9.45	12.1
Philippines	10.4	13.3	14.5	18.0
Singapore	1.7	2.2	6.0	7.5
S. Korea	2.6	6.9	8.5	11.5
Thailand	3.0	8.8	13.25	15.5

Source: JP Morgan Asian Financial Markets: Third Quarter 1998. Singapore April 24, 1998. [http://www.stern.nyu.edu/~nroubini/asia/afm2.pdf]; Asiaweek. 'Charting the Crisis.' July 17th 1998: 41.

Table 3: Economic Growth & Inflation

Country	Economic Growth (%)				Inflation (%)			
	1996	1997e	1998f	1999f	1996	1997e	1998f	1999f
China	9.7	8.8	6.5	6.0	8.3	2.8	-2.8	-0.5
Hong Kong	5.0	5.3	-3.0	1.6	6.0	5.7	3.2	-2.4
Indonesia	8.0	4.5	-14.0	-3.5	7.9	6.6	60.0	27.0
Malaysia	8.6	7.2	-5.1	0.1	3.5	2.7	6.1	6.7
Philippines	5.8	5.2	0.4	4.0	8.4	5.1	10.0	7.5
Singapore	7.0	7.8	0.0	0.1	1.4	2.0	1.3	1.7
S. Korea	7.1	5.5	-6.0	2.6	5.0	4.4	8.0	3.0

Thailand	7.7	0.5	-6.0	2.5	5.8	5.6	10.0	6.0

Source: JP Morgan Asian Financial Markets: Third Quarter 1998. Singapore April 24, 1998. [http://www.stern.nyu.edu/~nroubini/asia/afm2.pdf]; Asiaweek. 'Charting the Crisis.' July 17th 1998: 41.

Table 4 International Claims Held by Foreign Banks
(billions of US dollars)

Country	Total Debt (1995)	Short Term	Total Debt (1996)	Short Term	Total Debt (mid-1997)	Short Term
Indonesia	44.5	27.6	55.5	34.2	58.7	34.7
Malaysia	16.8	7.9	22.2	11.2	28.8	16.3
Philippines	8.3	4.1	13.3	7.7	14.1	8.3
Thailand	62.8	43.6	70.2	45.7	69.4	45.6
Korea	77.5	54.3	100.0	67.5	103.4	70.2
TOTAL	209.9	137.5	261.2	166.3	274.4	175.1

Source: Steven Radelet and Jeffrey Sachs, 'The Onset of the East Asian Financial Crisis,' World Wide Web document, URL: http://www.stern.nyu.edu/~nroubini/asia/AsiaHomepage.html, citing Bank for International Settlements data.

The long-term position of a number of the most badly affected countries is further constrained by their external debt positions. As Table 4 indicates, not only do the troubled economies share significant debt burdens, of which a substantial portion is short-term, but this further compounds negative sentiment toward them by potential external investors or creditors. Quite how dramatically the position of the troubled Asian economies has deteriorated is demonstrated in Table 5, which indicates the extent of non-performing loans throughout the region.

Table 5. Non-Performing Loans
(percentage of assets)

Country	1997	1998
Korea	16	22.5
Indonesia	11	20
Malaysia	7.5	15
Philippines	5.5	7
Singapore	2	3.5
Thailand	15	25
Hong Kong	1.5	3

Note: The figures for 1998 are forecasts

Source: Giancarlo Cosetti, Paolo Pesenti, and Nouriel Roubini, 'What Caused the Asian Currency and Financial Crisis,' World Wide Web document, URL: http://www.stern.nyu.edu/~nroubini/asia/AsiaHomepage.html, citing JP Morgan data.

Although the crisis has assumed an increasingly regional dimension, sweeping up one country after another in an expanding and seemingly irresistible downward spiral, it is important to recognise that it has generated different effects in different countries. In order to try and untangle those aspects of the crisis that appear to be connected with possibly universal problems of capitalism-in-general, and those that may be more specifically connected to 'Asian' forms of capitalism, it is important to try and unpack this latter category more carefully and distinguish it from other forms of economic organisation.

The End of Asian Capitalisms?

One of the most important issues to emerge during the crisis has centred on the way economic activity has been organised in East Asia. A good deal of attention has been devoted – particularly by the IMF - to developing plans to remedy the perceived shortcomings of Asian capitalism. Before the technical merits of such questions can be considered, however, it is vital to develop a clearer understanding of the much invoked term 'Asian capitalism'. In particular, we need to consider how East Asian forms of capitalism are organised differently from their counterparts in the Anglo-American economies. To understand how the East Asian variations on the general theme of capitalist development diverge from theoretical abstractions, therefore, we need to place them in specific social and historical contexts.

Capitalism in context

Although the defining qualities of capitalism – market-oriented commodity production; private ownership of the means of production; the necessary sale of labour power by the majority of the population; acquisitive, maximising behaviour on the part of individuals (Hunt 1979: 2) - are well enough known, they merit repetition, as it is important to remember that they are not simply timeless, universal or 'natural' givens, but dependent upon particular constellations of power and interest for their realisation. In other words, although capitalism as an abstraction may have enduring qualities that lend it analytical utility, the way the institutions and social practices that constitute capitalism are actually manifest vary from one historical setting to another. Whether these different forms are stages on the road to a single model or constitute viable alternatives is another question, one that is clearly of central importance in the context of the crisis.

The expansion of capitalism from its original European home to encompass not just Asia but the entire world made the idea of considering capitalism as one, all-encompassing global system increasingly attractive and appropriate. Whether the 'core-periphery' schema (Wallerstein 1974) is the most appropriate way of conceiving of an increasingly internationalised and interconnected system is another question, however. If there is one thing the pre-crisis performance of Japan and the so-called newly industrialising countries (NICs) seemed to demonstrate unequivocally, it was that economic development outside the 'core' was not only possible but could be achieved much more quickly than had been the case in Europe (Amsden 1990).

Yet in an increasingly global and interconnected political-economy it is not clear whether any region or country, no matter what form of economic policy or social system it favours, can insulate itself from major systemic disturbances elsewhere. This is an especially significant consideration given that one of capitalism's defining historical qualities has been a chronic proclivity for deep seated cyclical shifts that manifest themselves as 'booms' and 'busts' (Goldstein 1988). A key question, therefore, is whether the current crisis in East Asia is simply a 'normal' reflection of the internal dynamics of capitalism in general, or whether such inherent instability is compounded by the region's distinctive political and economic structures.

Asian capitalisms

Few would argue with the proposition that there are particular qualities which set capitalism apart in East Asia. Yet within this encompassing conception of 'East Asia' there are a number of distinctive historical patterns of development, very different types of state-business relations, as well more broadly conceived generic types of capitalist organisation. In trying to understand the way the crisis is likely to impact on the region it is important acknowledge these contingent factors as they will inevitably help shape the post-crisis political and economic order.

If one idea encapsulates a Northeast East Asian approach to economic management in particular, or is synonymous with the region's political economy more generally, it is the 'developmental state' (Johnson 1982). Pioneered by Japan, the developmental state is associated with a range of essentially mercantilist trade and industry policies that are designed to force the pace of industrialisation and promote national economic development. Central to this developmentalist project is the desire to harness the totality of resources available within the politically demarcated space over which the state claims authority in pursuit some notion of a 'national interest'.

In Japan, the imperatives of post-war reconstruction provided the legitimating rationale for the single-minded pursuit of economic growth. While the desire for rapid economic growth may not have been an exclusively Japanese preoccupation, what distinguished Japan was the way its governing elite set about achieving it. The underpinning dynamic in Japan was still capitalist, but because the pursuit of profit occurred within a contingent Japanese context - with all the historical specificity that implies - it effectively harnessed capitalist dynamism to national purpose (Tabb 1995: 199). In short, what emerged in Japan was a form of coordinated capitalism which effectively consolidated and was mediated by existent social relationships and institutionalised patterns of organisation. Of central importance in this regard was the structure of the state-business relationship. Not only was the bureaucracy in Japan technocractically competent and capable of providing a blueprint for national reconstruction, but they had sufficiently close links with, and leverage over, local business to ensure that their plans could be carried to fruition (Calder 1988).

Japan has a wider significance in the context of the current crisis. First, not only is Japan still by far the most important economic power in the region, but it has provided an important developmental exemplar for other East Asian nations. The first generation of NICs to emerge after Japan, especially Taiwan and South Korea were directly influenced by the Japanese during the latter's period as a colonial power (So and Chiu 1995), reproducing a range of Japanese-inspired industrial structures, policies, and state-business relations. A second generation of NICs in countries like Indonesia, Malaysia and Thailand have subsequently been caught up in a complex web of production structures, loan and aid packages which have tied them to Japanese companies as they have expanded into the region (Hatch and Yamamura 1996). A second, more subtle Japanese influence has been ideational. East Asian economic development has been premised on the idea that domestic governments – unlike their counterparts in the Anglo-American nations – could and <u>should</u> lead rather than follow markets (Wade 1990). In short, thinking about economic development and the appropriate role of government in that process has been shaped by a range of influences and economic models that are significantly different from the nostrums and idealisations that are associated with the neoclassical economic orthodoxy that predominates in countries like Australia and the US (Fallows 1993). In short, Japan has developed a generic form of capitalism that stands as a distinct alternative to the sort of model that the IMF is currently trying to impose on the region.

Yet the currently parlous state of the Japanese economy raises import questions about the competence and capacity of public servants and governmental agencies in an increasingly complex and inter-linked global political-economy. The numerous corruption scandals that have plagued the hitherto highly esteemed bureaucracy suggest that there is much than can go wrong when potentially mutually beneficial relationships between state officials and private businesses become entrenched over time. These are issues that are central to not only understanding the origins of the crisis itself, but of trying to judge its impact on the distinctive political and economic structures of East Asia. Key questions revolve around the continuing utility of coordinated forms of capitalism: Are such arrangements only useful in the earlier phases of industrialisation or 'catching-up'? Do the enduring, cooperative relations between business and government that facilitate planned economic development inevitably risk descending into self-serving venality? In the longer-term, do the processes associated with 'globalisation' make such relationships either unsustainable or irrelevant?

A number of responses to such questions are presented by the authors in this volume. Weiss and Hobson, for example, consider that the 'strong' states of Northeast Asia in particular can 'convert external constraints into domestic opportunities', and emerge comparatively well from the crisis. Similarly, James Cotton argues that the 'enterprise associations' of Singapore and Taiwan provided a rational and structural basis for a specific form of economic and political organisation that has insulated these countries from the worst ravages of the crisis. However, Hyuk Rae Kim argues that the capacity of even the most technocratically competent of East Asian states to respond effectively has been fundamentally undermined by the crisis. Kim's other chapter with Yeon-Ho Lee, which considers South Korea's experience, gives a good deal of support to this proposition. Perhaps Kanishka Jayasuriya's paper points the way forward from some of these apparently incommensurate positions: it is not so much a question of an absence or diminution of the state's regulatory effectiveness, but of new forms of regulation. In other words, even in the face of an apparently relentless tide of IMF-inspired neoliberal reform, governments are involved in a process of re-regulation rather than de-regulation (Vogel 1996; Cerny 1991).

There is another point that merits re-emphasis in any discussion of the role of the state in the region: that is, the importance of distinguishing between the different versions of the 'East Asian model'. A consideration of the Southeast Asian experience suggests that while the Japanese exemplar may have exerted an influence, its realisation in a Southeast Asian context generally owes little to the stylised – not to say idealised – depictions of technocratic elites promoting the collective good. On the contrary, a country like Indonesia, dominated as it has been by a close knit oligarchy that has been the principle beneficiary of economic development, is closer to a 'predatory' state than the developmentalist ideal (see Evans 1995). True, Indonesia's economic development has generated more widely-dispersed benefits than has been the case in comparable African regimes, but the locus of political and economic power has remained with the dominant politico-bureaucratic elite. Indeed, the point to emphasise in the Indonesian case is that state power has been utilised to cement the position of elite itself, not in the pursuit of some more broadly based conception of the national interest (Robison 1997).

Although the Indonesian case is perhaps extreme, it is not unique. A number of countries in the region have demonstrated a potential for predatory statism (Hutchcroft 1994), or for the more entrenched fusion of political and economic power that characterises a country like Malaysia (Gomez and Jomo 1997). The chapters by Robison and Rosser on Indonesia, Hewison on Thailand, Walden Bello on the Philippines, and Khoo Boo Teik's analysis of the Malaysian experience suggest that the crisis itself and the reformist ambitions of both external and internal actors will profoundly affect domestic political-economies across Southeast Asia. If, as seems increasingly likely, the crisis drags on and intensifies, then the possibility that such reforms will either generate nationally-based forms of resistance or create further instability by accentuating domestic tensions is all too real. As Beeson and Bell indicate in their consideration of Australia, even a country which has enthusiastically embraced neoliberal reform is not immune from the discomforting economic and political impacts of increased international integration. In short, the preconditions for what Higgott calls the 'politics of resentment' are in place across the entire region.

Nowhere are the social complexities of the crisis more apparent than in the potential for inter-ethnic conflict, particularly involving the so-called 'overseas Chinese'. Although we need to be careful about homogenising a large number of people from increasingly disparate national contexts under this convenient rubric (Brown 1998), there are, nevertheless, sufficient commonalities about Chinese business practices to allow Chinese capitalism to stand as another ideal-typical entity. Chinese capitalism continues to reflect the social, institutional and cultural milieu within which it is embedded

(Redding 1990), and represents – along with the Japanese variant described above – an important generic form that could play a potentially important role in the resolution of the crisis, especially in Southeast Asia. As such, it continues to be characterised by a relatively small scale, family-centred business structures, which generally substitute personalism for the supposed rationality of its Anglo-American counterparts. In short, different relationships and connections (guanxi) provide the underpinning basis for a complex network-based organisational structure that will not be easily altered by neoliberal reforms and calls for 'transparency'. Indonesia is perhaps the most obvious illustration of both the economic importance and political influence of Chinese capitalism and of the potential for such relationships to generate widespread social unrest.

The final point to make about this brief sketch of Asian capitalism is that the theoretical and ideological prism through which the East Asian experience is refracted will inevitably colour subsequent conclusions. The theoretical assumptions of much neoliberal economic thought, particularly the normative and methodological privileging of the individual rather than the group (or more specifically in the current regional context, the network), means that many of the most distinctive qualities of East Asian capitalism are simply not captured (Biggart and Hamilton 1992). The type of theoretical paradigm that is employed, therefore, is likely to determine not only the way we see, or indeed define problems for analysis, but the sorts of policies that are put in place as a consequence. This possibility is most obvious in the link between the neoclassical tradition of economic thought which has assumed such a paramountcy in the Anglo-American nations, and the normative pursuit (or imposition) of market-centred reforms (Gordon 1994). We shall critically assess a number of the more useful or influential theoretical perspectives in the final part of this chapter. Before that, however, it is important to situate East Asian forms of capitalism in their overarching and increasingly 'global' context.

East Asia and Globalisation

In a number of analyses of the crisis writers from a range of backgrounds, from orthodox liberal economists like Jeffrey Sachs (1997), to the more radical perspective of Jeffrey Winters (this volume), have stressed the importance of the global financial system in precipitating the crisis. Such views raise a number of important questions. First, what specific changes in the international political economy may have been implicated in the crisis? Second, what are the implications of such changes for nation-states? In short, is it still possible for a range of national or regional responses to be generated to apparently ubiquitous international pressures, as the analysis of Higgott (this volume) or the recent actions of Malaysian Prime Minister Mahathir seem to suggest? These are critical questions, for if global financial markets in particular and the reconfigured international system in general are responsible for a crisis that shows every sign of affecting non-Asian economies, then dismantling 'crony capitalism' or discouraging dirigiste regimes may do little to address the underlying structural problems of capitalism per se.

In order to answer some of these questions, we need to be clear about how capitalism has evolved generally. This section, therefore, sketches the most important structural developments in the interconnected, international economic and political system, changes which are routinely subsumed under the rubric of 'globalisation'.

The industrial and financial sectors

The most visible expression of East Asia's incorporation into what is an increasingly global economy has been, until recently at least, its role in what has been dubbed the 'new international division of labour' (Frobel et al 1978). A number of changes in the way productive processes are organised over recent years have allowed production to be dissaggregated and spatially dispersed over a number of locations that may transcend national borders (Dicken 1992). While the region has clearly enjoyed a number of benefits from its integration into global production processes and networks, the crisis has had the effect of revealing a number of long-term structural problems in the underlying 'real' economies of both the region and wider international system.

Inward investment flows associated with new, internationally-organised structures of production are now generally welcomed, if not actively pursued by host nation governments. Although East Asia has attracted increasingly significant flows of foreign direct investment (FDI), they have recently tended to be overwhelming directed toward one country – China. As Lance Gore points out in Chapter ??, China's own political and economic practices in combination with new inflows of capital have contributed to a major build up in the region's manufacturing capacity. This is exacerbating an historical crisis of excess productive capacity and declining profitability throughout the world, a growing problem that has been manifest in increasingly intense inter-regional contestation between the North America, Europe and East Asia (Brenner 1998). This not only makes any immediate, export-led recovery from the present crisis more difficult, but directs attention to potentially more fundamental problems with capitalism in general. The remarkable increases in the productivity of manufacturing processes in particular has generated the preconditions for a systemic crisis centred on a major imbalance between supply and demand. The crisis, therefore, may be highlighting a global, rather than a simply East Asian problem of structurally entrenched unemployment, saturated markets and chronic over-capacity (Greider 1997).

These problems have been compounded by the prominent role played by financial capital during the crisis. Financial capital is most easily distinguished from FDI by its more attenuated relationship with 'real' economic activity. Simply put, financial capital is not directly involved in or committed to long-term involvement in productive activities, but operates through a range of intermediaries or financial instruments which allow its controllers to maintain a high degree of potential mobility. In other words, financial capital can move rapidly in and out of national economic space in response to changing circumstances. This has become a especially critical issue in an era when by some estimates up to US$2 trillion passes through the world's currency markets every day, of which more than 97 per cent is speculative and unconnected with the production of goods and services (Lietar 1997: 15). The scale, scope and visibility of the markets is significant enough in itself, but when combined with the apparent inherent historical tendency for disjunctures to emerge in the pace of expansion in the financial and industrial spheres of international economic activity (Arrighi 1994), then the potential for crises is compounded. Certainly, increasing volatility in global equity, bond and currency markets suggest that such systemic crises and imbalances are not confined to the Eastern side of the Pacific.

This is an even more important consideration given that one of the more important aspects of the present crisis has been the so-called ‘contagion effect’, in which what were initially taken to be localised problems, rapidly spread to other countries. In the contemporary inter-linked world economy, individual nation-states, especially those with smaller economies, appear to be extremely vulnerable to rapid shifts in market sentiment (Beeson 1998). The relative size of the economic forces ranged against individual countries is of critical importance here. The dramatic growth of mutual funds and large-scale institutional investors in countries like the US means that where the governments of smaller economies have loosened control over domestic economic activity in line with international trends, then national currencies and the course of domestic development may be at the mercy of forces beyond the control of individual governments. While the degree of vulnerability or insulation experienced by individual countries is clearly variable and something that needs to be determined in specific circumstances, it seems plausible that much of the impact of the spreading crisis may be derived from the sheer increased scale and rapidity of financial sector movements.

An inevitable corollary to the resolution of the current crisis will be a re-examination, if not a reformulation of the regulatory framework within which capitalism operates. Inevitably, however, the construction of a new ‘financial architecture’ will be shaped by the constellations of political forces within nations, the varying power of individual nations in relation to each other, and the increasing influence of transnational or non-state authorities. Greater capital mobility has had the effect of entrenching new domestic cleavages, not simply between ‘capital’ and labour, but within different elements of nationally- or internationally-oriented producers (Frieden 1991), and between them and the controllers of more liquid, footloose financial assets. An important impact of the internationalisation of economic activity, therefore, is to re-configure the interests upon which domestic political coalitions rest (Milner and Keohane 1996: 16).

The potential importance of this realignment of domestic forces in response to international pressures is clearly demonstrated in the case of Japan, the most important economic actor within East Asia. To put the matter briefly, changes in the international financial system have not only reduced the ability of Japanese state officials to manage the domestic economy, but have affected the nature of the relationships between the financial and industrial sectors within Japan. A key change in this regard has been the growth of disintermediated credit in the Japanese system. In other words, the control and more particularly the allocation of credit has steadily moved beyond the purview of governmental control (Leyshon 1994). Not only is this a profound transformation of domestic political relations and the relative influence of key actors within Japan’s political economy, but it is emblematic of a fundamental challenge to the very basis of East Asian capitalism. The distinctive East Asian form of a <u>credit</u>-based capital provision, (rather than the Anglo-American market-based model of finance), in which the state and the domestic banking sector are the principal sources of credit allocation

(Zysman 1983), would seem to be directly threatened by the growing power and ubiquity of international financial markets.

State authority, and the entire interventionist style of economic development in East Asia appears to be inevitably diminished by the current crisis and the potential imposition of further neoliberal reforms. While the implications and extent of these changes need to be analysed in specific national contexts, there does seem to be prima facie evidence, therefore, of a degree of 'convergence' in response to similar imperatives and structural constraints. Importantly in the context of the East Asian crisis, however, there appears to be a desire on the part of key transnational authorities and actors to try and encourage a process of convergence, or even impose structures and practices which conform to 'western' idealisations. In short, there is an increasingly important and overt <u>political</u> dimension to the globalisation process.

<u>The politics of globalisation</u>

The idea that the authority of nation-states is seriously compromised by processes associated with globalisation has become one of the staples of popular and academic commentary (Ohmae 1996). Yet as we saw in the case of Japan, while the internationalisation of economic activity does have the effect of re-configuring the relative power of domestic political forces, this does not necessarily imply that the state itself is a less effective or important actor as a result. Clearly, any form of capitalism is ultimately dependent for its long-term realisation and continuance on the sort of legitimating authority and legal infrastructure that only nation-states can provide (Heilbroner 1985). And yet there clearly <u>have</u> been important changes in the state's position, especially as a consequence of the internationalisation of economic activity. Susan Strange (1996: 43) argues that the 'shift [of power] away from states towards markets is probably the biggest change in the international political economy in the last half of the twentieth century'.

States, then, are bound up in a complex web of transnational relationships, interdependencies and commitments which play a fundamental role in defining not only their own position and power, but also the shape of the increasingly multilateral international system of which they are a part. Yet the international political-economy which has evolved in the post-war period is a <u>particular sort</u> of system, one which reflects the interests, preferences and power of its members. Increasingly, the rules and norms that govern the contemporary international system are associated with so-called 'Washington consensus', which is predicated upon market-centred polices of privatisation and liberalisation (see Williamson 1994). In short, the consolidation of neoliberal policies is associated with a range of reforms and initiatives that are designed to both entrench the position of market mechanisms and to advantage those firms and nations that are best able to take advantage of them. In other words, a critical issue highlighted by the crisis is whether market-centred reforms are simply a-political technical responses to particular economic difficulties, or whether they are part of a wider agenda of reform designed to further particular national interests.

The role played by the International Monetary Fund in attempting to manage this crisis highlights many of these issues, as Richard Leaver demonstrates in chapter ?? Given that IMF not only symbolises the new reality of inter-governmental relations, but has also been the most important and visible agent of neoliberal reform, it is worth making a couple of brief additional points about this key organisation. The major point to emphasise is the thorougoing nature of the reforms being proposed by the IMF. As Robison and Rosser argue in chapter??, the IMF reform agenda is designed to 'strike at the heart of politico-business and conglomerate power'. In other words, the IMF is not simply interested in attempting to stabilise immediate economic dislocation in Indonesia, but in making profound long-term changes to the organisation of economic and political activity in Indonesia. Given the intimate historical association between the IMF and the US and its foreign policy goals (Pauly 1997), then it is reasonable to ask whether the key inter-governmental institution charged with resolving the crisis is pursuing a politically neutral agenda of exclusively economic reform, or one which is shot-through with national implications and political imperatives. As Higgott (chapter ??) argues, it is a perception that may provide a lightening rod for regional resentment and future conflict.

As the very different perspectives taken in this volume by Winters on the one hand and Weiss and Hobson on the other demonstrate, there is clearly an important debate about the role played by the US in attempts to reconfigured East Asian political–economies. What can be said is that the end of the Cold War has profoundly reduced East Asia's strategic leverage over the US, and opened up a possibly unique, historic window of opportunity for those forces that which to restructure political and economic activity in the region along more 'western' lines. This raises a further and critically important question: why do economic systems change? In other words, why do market orders function differently form one country to the next? In order to try and unravel this key question and begin to make theoretical sense of the crisis, we shall critically review a number of the more important and influential perspectives that have tried to make sense of East Asia and capitalist development more generally.

Understanding Outcomes: How Do Markets Change?

In the face of overwhelming pressures to reform, it is striking that change in the region has been contested and uneven. As a number of the contributors to this volume demonstrate, entrenched interests across the region continue to resist change. Opposition comes from vested business interests under threat from proposed bankruptcy laws, trade reform and the closure of insolvent banks, as well as from middle classes and workers for whom high interest rates, inflation and fiscal contraction undermine the gains of the past two decades. The varied impacts and effects of the crisis on the region raise broader questions about the way economic structures and social systems change.

How do we understand such contests? Do they represent the final struggles of rent-seekers and predators in the face of the inexorable, timeless and universal rationality of market mechanisms? Or are they conflicts between contending systems of power and interest? Are free markets and political democracy functionally necessary for capitalism? Or are these simply the institutions that emerged from the circumstances in which capitalism arose in nineteenth century Europe? Can market economies exist within a range of institutional frameworks including political authoritarianism? There are a number of theoretical perspectives that might be utilised in trying to answer such questions, which for the sake of convenience we have divided into a neoliberal perspective, a paradigm which sees markets as constructions of government and politics, and theorists who see markets as structured by relations of power and interest.

Neo-Liberal explanations

In contradiction to their previous optimism that the 'Asian Miracle' would continue into the Asian Century on the basis of sound economic 'fundamentals' (Radelet and Sachs 1997), neo-liberals have explained the crisis as an inevitable functional breakdown of economies in which governments attempt to resist the rationality of markets (Friedman 1997; Camdessus 1997). As the cost of resisting markets becomes too high, reflected in over-valued assets, poor investment decisions and burgeoning debt, rational individuals seek greater efficiencies in the allocation of economic resources through the natural and neutral mechanism of the market. Likewise, individuals seek to reduce transaction costs caused by lack of information and predicability by constructing rules and regulations to constrain the predatory actions of 'rent-seeking' officials and business interests (World Bank 1983; North 1994).

Despite the elegant and frictionless process of change assumed above, neo-liberals have had to recognise the politically contested nature of economic transition. These contests are seen as resistance by rent-seekers, who prosper from government intervention in the operation of markets, and who capture both rents and the very institutions intended to regulate economic life (Krueger 1974; Olson 1982). Consequently, neo-liberals see the primary task as minimising the influence of the inevitably predatory institutions of state power (Buchanan and Tullock 1962). From this perspective, the crisis is a blessing in disguise. It offers an opportunity to dismantle protective trade and financial regimes, industry policies, and the structures of 'crony capitalism'. Consequently, besieged governments seeking investment and debt rescheduling now find it increasingly difficult to resist demands from global funds managers and bankers to liberalise their trade regimes or to reform their banking systems. As IMF Chief, Camdessus' has argued, to receive the benefits of global financial markets countries had to adhere to its disciplines (cited in Saludo and Shameen 1997). Yet, neo-classical theorists confront a contradiction. They have increasingly recognised that it is only within institutions able to stand above vested interests that collective problems may be resolved. Hence the emphasis placed on institution building and 'good governance' and the recognition that the state has a role to play (World Bank 1997.

Neo-liberal approaches, therefore, embody several major problems. First, if the utility-maximising individual is the engine of change, how are collective interests identified and institutions established to enforce them? Chaudhry's (1997) question is central: who should manage these institutions and on what basis? A second problem lies in the assumption that markets are mechanisms abstracted from state power and social and political interest. The view that changing institutions is a technical matter is contradicted by the continuing inability to impose deregulation and craft 'good governance' in the form of transparent and accountable institutions. In Indonesia, for example, attempts in 1965, 1982 and 1986 to impose liberal market reform failed because economic crises did not break the dominant political and social order. Such cases suggest that market economies may require specific social and political pre-conditions.

Markets as the Creations of Governments and Politics

Following the traditions of Weber and Polanyi, a range of theorists, including Chalmers Johnson and John Zysman have argued that markets do not exist in isolation from state power, and are not timeless, universal essences, but the creations of government and politics (Zysman 1994). Developmental elites within the state apparatus, in this view, can and do create specific market structures through a range of coordinated industry policies, strategic trade initiatives, and financial regimes. In Wade's (1990) terminology, these are managed or governed markets. What is more, they often survive, as Amsden (1989: 13/14) pointed out, by countering the conventional wisdom of the market and 'getting prices wrong.'

In this view, markets do not exist independently of the institutions that define them. Because change occurs in the context of historically-determined institutional pathways, crises are accommodated within a central logic defined by layers of institutions - whether they be British trade union systems of labour or the credit-based industrial economies of Japan or France. Hence, in this view there is not one form of capitalism but many. Such an explanation has the advantage of explaining why it is so difficult to change economic systems and why apparently similar institutions when translated from one society to another often produce different outcomes.

But the crisis appears to have seriously damaged the statist position. High-debt strategies balanced on collusive arrangements between governments, banks and business were left vulnerable as the currencies collapsed. It appears that state managed or governed markets may indeed contain essential functional flaws. Statist theorists have explained the crisis, not as evidence of the irrationality of governed or managed markets but as the consequence of foolish and imprudent reforms that led to the collapse of institutional capacity (Weiss and Hobson, this volume). Hence, the current task is to restore the institutional framework that made previous systems so successful.

There are several difficulties in this approach. Change is explained in terms of incremental rational choices that produce historical layers of institutions which in turn impart a degree of path dependency. There is a tendency to reify institutions to the extent that we are unable to explain great shifts in history and the dramatic collapse of existent institutional frameworks as other than mistakes in design by developmental elites. This is the case in the present crisis (Wade and Veneroso 1998). However, reforms to economic regimes in the 1980s were not simply foolish miscalculations by bureaucratic elites, but the related shifts in political and social power that were reflected in policy and constitutional change, not least in the emergence of democratic politics.

Restoring the old institutions is not, therefore, a technical matter but one that implies nothing less than a social counter-revolution. The challenge for institutional theorists that seek to do more than simply describe institutional variety, therefore, is to define the boundary between optimal institutional embeddedness and the development of self-serving distributional coalitions.

Markets as Relations of Power and Interest

In western social theories of markets, originating largely from within the classical Marxist tradition, all economic systems are understood as relations of power and interest. Consequently, the opponents of neoliberal reform are not dismissed as rent-seekers or vested interests, but as cohesive, entrenched political and social entities. Liberal market economies, no less than any other system, are embedded in particular constellations of state and social power. Change occurs, in this view, when legal, political and economic institutions, which were established to facilitate particular systems of economic production and to impose the architecture of social relations embodied in them, become constraints on the emergence of a new order. Hence, institutions are constructed to maintain and allocate power, not just to impose rational economic regimes (Bardhan 1989). The process of change involves political struggle to shape the rules that govern markets.

Like neo-liberals, although for different reasons, Marxists have also assumed that capitalism would lead inexorably to the development of market economies and political democracy. Embracing the globe, capitalism would contain within it a particular hierarchy of social power and interest, and involve a sweeping away of existing social order. The fact that capitalism has evolved within a wide range of institutional frameworks - from the highly centralised developmentalist states of Bismarck's Germany and Meiji Japan to the predatory oligarchies of Indonesia and the Philippines – presented problems. While both liberal and Marxist theorists have explained such stages in terms of the absence or weakness of middle classes or business interests, this has not always been the case. Transitional stages are better defined in terms of different historical conjunctures of relationships and alliances between capitalists, the state and its officials, middle classes and workers (Marx 1969). Within the Marxist framework, it is assumed that these stages will be transcended as capitalism matures, markets are entrenched and the bourgeoisie achieves a hegemony that renders their protection under the umbrella of authoritarian states and dirigiste economic systems no longer necessary (Harris1988).

Within this paradigm, the crisis may be explained in the context of two questions. Will it undermine the structural base of entrenched political and social coalitions, or are they able to accommodate such challenges? Moreover, even if existing regimes decay as they succumb to fiscal crisis and social unrest, is there any guarantee that liberal market economies will spontaneously emerge? As a number of contributions to this volume suggest, a retreat to oligarchy, nationalism or a decline into chaos are possibilities that can not be ruled out. A second question, therefore, is whether the crisis strengthens reformist coalitions whose interests are served by markets, rule of law and political democracy.

There are, then, a number of theoretical frameworks with which it is possible to try and make sense of the current crisis. While they may all have something to tell us, the key test of their efficacy is their ability to illuminate the contingent dynamics that have shaped recent events. While capitalism may display some universal properties, any plausible account of the crisis must recognise that capitalism in Asia has been realised in distinctive ways that will not easily be swept aside, nor which will inevitably or painlessly 'converge' an a supposedly technically superior western model. Indeed, as the crisis threatens to spill over into the rest of the world - including North America - the Anglo-American variant of capitalism may come in for an equally searching scrutiny which may remind us of the contradictory and crisis-prone nature of capitalism in general, rather than of East Asian capitalism in particular.

Concluding Remarks

This chapter has tried to place Asian capitalism in a specific historical context and identify some of the key issues that will influence its future development in the wake of the crisis. One of the most noteworthy features that has emerged from the crisis has been the extraordinary change in perceptions of the region and its prospects. It is important to remember that until very recently key international institutions like the IMF and the World Bank (1993; 1997) had nothing but praise for the developmental states and the primacy they attached to 'getting the fundamentals right' (Berger and Beeson 1998). Not only do orthodoxies change, it seems, but some views are clearly more salient than others in constructing the conventional wisdom. It is not necessary to be a Marxist to recognise that powerful nations are able to use their positions' to make their visions of the way the world works pre-eminent (Ikenberry and Kupchan 1990), and thus the basis for 'cooperative' international actions. As a number of contributors to this volume note (see, for example, Winters), the overarching geo-strategic framework within which inter-regional relations are conducted has been transformed in the wake of the Cold War's end. The US, often through IMF auspices, has attempted to re-shape East Asia and its institutions along neoliberal lines, unconstrained by formerly dominant strategic imperatives (Beeson forthcoming). In short, it is inconceivable that the crisis would have unfolded in quite the way it has if the central dynamic of the international system had not shifted from 'high' politics to 'low' commerce (Luttwak 1990).

There are, then, powerful international forces associated with both the creation and the attempted resolution of the East Asian crisis. It is worth reiterating some of the key questions that have emerged from this chapter, and which will need to be addressed - either explicitly or implicitly – if the crisis is to be resolved. First and foremost, is the crisis a crisis of capitalism or of <u>East Asian</u> capitalism? Are Asian economic and political structures – even in their most technocratically competent and benign Northeast Asian manifestations – simply unable to adapt to or cope with the seemingly irresistible array of forces associated with globalisation? Or is the East Asian crisis a manifestation of some more fundamental and possibly new or heightened 'contradiction' of capitalism itself? In short, how much of East Asia's problems are due the domestic incompetence or corruption, and how much to an international economic system that is fundamentally unstable and which may ultimately affect the North American and European legs of the Triad?

Other more immediate questions concern East Asia more directly. Despite the economic origins of the crisis, the key questions that flow from it are political. Put simply, how will the crisis affect domestic and international political relations? The dramatic downfall of the Suharto regime suggests that if the crisis drags on or becomes worse – as seems all too likely – there may be further political trauma in the region. Will this encourage democratisation as optimists hope, or will the pressures exerted by collapsing economies and concomitant social unrest see a move back toward authoritarianism? Indeed, will there be a backlash against the entire project of further neoliberal reform – and its extra-regional sponsors - especially if it is unable to deliver any obvious benefits in the short to medium term? The period between the two World Wars provides a sobering reminder that there is nothing inevitable about the course of economic development or international relations.

If the current economic dislocation ultimately proves to have more to do with a crisis of capitalism, than it has to do with a crisis of Asian capitalism, then the vectors of influence and admonition that are currently pointing unwaveringly toward the region may be reversed. In the event of a more generalised global crisis of capitalism engulfing North America and Europe, then the sort of state-led economic strategies that East Asia perfected may well prove valuable again. And yet this may highlight a key paradox if not contradiction of the crisis: it is possible to argue that some there are still aspects of Asian capitalism – particularly its capacity for coordination and its potential for a more equitable distribution of the benefits of economic development - that make it functionally superior to it Anglo-American counterpart. But in an era where power is increasingly shifting from states to markets, and in which the world's most powerful nation cooperates with increasingly influential inter-governmental authorities to impose a market- rather than a state-centred economic order, the East Asian model will not survive unless there is a transformation of the wider system of which it is a part. As the crisis spreads and the more questions are asked about the stability and efficacy of a predominantly neoliberal world order, such a possibility can not be ruled out.

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